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# SUBDIVISION INDUSTRY BULLETIN

Arnold Schwarzenegger, Governor  
Dale Bonner, Secretary, Business, Transportation, & Housing Agency  
Jeff Davi, Real Estate Commissioner  
Spring 2008

Department of Real Estate

## Sales inducements and promotions

**T**he Notice of Intention filed by a subdivider for a public report inquires as to whether gifts, free trips, rebates or other similar promotional marketing devices will be offered. Gifts or other special sales inducements involving a financial commitment to purchasers ordinarily should be furnished by the subdivider prior to close of escrow. Escrow instructions must include specific provisions requiring delivery of the inducement before escrow can close.

Alternatively, the applicant for a public report must make financial arrangements to fulfill any promise that constitutes a sales inducement if the promise is one that cannot be performed before the close of escrow. Financial arrangements may include performance bonds, letters of credit, or cash in the custody of a neutral escrow operating under appropriate instructions as provided in RE Form 609.

The most prevalent inducement in a common interest subdivision offering is the subdivider's promise to subsidize the monthly assessments for operating and

maintaining the common facilities. The subdivider may credit the buyer the full amount of the subsidy at close of escrow or post a surety bond with the association as obligee. The bond amount would be 100% of the value of the subsidy.

Individual inducements to purchasers that will not be completed prior to close of escrow will require a security device such as a surety bond with the individual buyer as obligee to the bond. The homeowner's association can only be an obligee to a bond if it is a direct party to the gift or inducement.

Regulation 2800 (d)(2) specifically requires notification to the DRE as a material change in the offering if the subdivider, subsequent to the initial issuance of the Final Public Report, elects to offer a special sales inducement involving a financial commitment to purchasers. Prior to permitting subdividers to offer the inducement to perspective buyers, the DRE will review the arrangement and

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## New PUC requirements

**T**he California Public Utilities Commission (PUC) has jurisdiction over private water companies. On October 22, 2007, PUC notified the Department of Real Estate (DRE) that effective immediately, all Class A Water Utilities (more than 10,000 service connections) are exempt from filing completed water supply questionnaires with the PUC for serving new subdivisions or customers within their existing service area.



The following is a list of Class A Water Utilities:

- Apple Valley Ranchos Water Company
- California Water Service Company
- California-American Water Company
- Golden State Water Company
- Great Oaks Water Company
- Park Water Company
- San Gabriel Valley Water Company
- San Jose Water Company
- Suburban Water Systems
- Valencia Water Company

If the water supplier is one of the above listed water utilities and the subdivision is within their existing service area, then a PUC confirmation approval letter will not be required prior to the issuance of a final public report. DRE will require confirmation from the water utility that the subdivision is within their existing service area.

For all water utilities serving subdivisions outside their existing service area or having less than 10,000 service connections, a PUC confirmation approval letter will still be required. ♦

## New regulations effective March 15, 2008

**R**egulations 2790.8 and 2790.9 become effective March 15, 2008. These regulations provide enhanced disclosures concerning the condition of the property in condominium conversion and/or existing subdivision projects.

Additionally, the subdivision review process will be standardized by requiring the disclosure document be provided to the buyers of, not only condo conversion projects, but of any "Existing Subdivision Interest". Existing Subdivision Interests are defined as subdivision interests that have been completed or occupied for 3 years or more.

These regulations will improve consumer protection by providing buyers of units/lots in converted/older properties with a unit/lot specific disclosure of the condition of the subdivision interest. The disclosure is patterned after the Real Estate Transfer Disclosure Statement required to be given to buyers of general resale properties pursuant to California Civil Code Section 1102 and was fully vetted with the California Building Industry Association. Please refer to the DRE Web site for full regulation language. ♦

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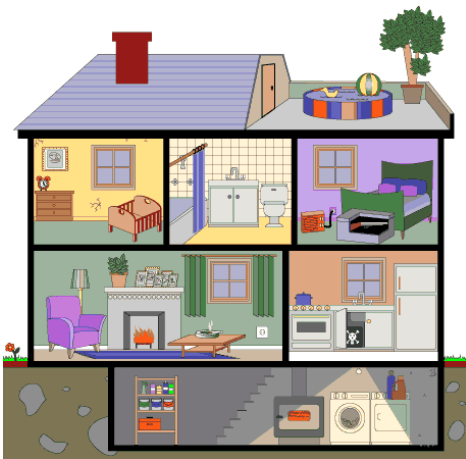
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## Summary of 2007 legislation affecting subdivisions industry

October 14, 2007 marked the end of year one of the current two-year legislative session. A total of 964 bills wound their way through the process and landed on the Governor's desk. Of these bills, 750 were signed into law and 214 were vetoed. The following brief legislative summaries are of legislation from the 2007 session that affect real estate subdividers. These summaries are intended to alert you to pertinent changes to the law. We encourage you to consult the statutes for complete information. Copies of the bills can be obtained on-line at [www.leginfo.ca.gov](http://www.leginfo.ca.gov). Please note that "SB" refers to a Senate bill and "AB" to an Assembly bill and the Chapter number refers to the sequence that the bill was filed with the Secretary of State. The name appearing after the bill number is the name of the author. All statutes are effective January 1, 2008 unless otherwise noted.

### *AB 432 (Garcia) Time-share Public Reports (Chapter 53)*

The Vacation Ownership and Time-Share Act of 2004 (VOTA), effective 7/1/05, changed how time-share offerings are regulated in California. The act requires a timeshare plan developer, prior to selling timeshare interests, to obtain a public report from the DRE. The public report application requires the developer to fully and accurately disclose certain facts concerning the time-share developer and time-share plan.

AB 432 will allow a developer to submit a public report application that combines, in a manner prescribed by the commissioner, the information required to be disclosed by California law and the information required to be disclosed in a public report issued by a regulatory agency in one or more other states. This will allow a developer to create a single disclosure document that is potentially valid in the states where the time-shares are marketed.

The Department of Real Estate sponsored AB 432.

### *AB 691 (Silva) Homeowner Association Managers; certification (Chapter 236)*

While existing law does not require managers of home owners associations (HOA) to be licensed, the law does prescribe requirements for the certification of HOA managers. Specifically, existing law requires the completion of specified educational requirements in order for a HOA manager to be considered certified, although there is no requirement that an individual be certified in order to manage a HOA. The provisions in existing law that set forth the requirements for HOA manager certification will sunset on 1/1/08.

AB 691 extends the sunset date to 1/1/12 and modifies the requirements for HOA manager certification.

The California Association of Community Managers sponsored AB 691.

### *AB 763 (Saldana) Subdivision; conversions; notice (Chapter 612)*

The Subdivision Map Act (Map Act) generally requires an apartment owner to give tenants notice that the property in which they live will be converted from rental units to condominium units and will be offered for sale. AB 763 deletes the current notification procedure and creates new tenant notification requirements that must be fulfilled prior to the approval of a final subdivision map for the conversion of residential rental property into condominiums.

This bill also requires that if a rental agreement was negotiated in Spanish, Chinese, Tagalog, Vietnamese, or Korean, all required written notices regarding the conversion of residential real property into a condominium project, a community apartment

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# Tenancy in common projects

As reflected in numerous inquiries from the public and applications for public reports, tenancy in common projects, involving the conversion of apartment buildings to tenancy in common form of ownership, have been the source of increasing interest in recent years. Because Real Estate Law does not define tenancy-in-common (TIC) subdivisions per se, many people are uncertain about the Department of Real Estate's regulation of this type of subdivision.

A TIC offering involves the sale of undivided interests in an apartment building accompanied by the right to exclusive occupancy of a residential unit, but without any unit assignment shown in the conveyance document, purchase agreement or grant deed, or other recorded instrument. Purchasers will not own a unit or any other particular part of the TIC property. The relationship among the TIC owners is governed by a written TIC agreement, a contract signed by each purchaser that denotes which unit each owner is entitled to occupy. TIC projects are undivided interest subdivisions as described in Section 11000.1 of the California Business & Professions Code and are regulated under Section 11000 et seq. of the Code, including Code Section 11004.5. A TIC is subject to the provisions of the Subdivided Lands Law if undivided interests are created in a project consisting of five or more units.

Most applications for tenancy in common public reports involve properties in San Francisco for reasons that may include the demand for more affordable housing, the difficulty in obtaining permission to convert apartment buildings to condominiums, and the fact that conversion to tenancy in common project does not require a subdivision map.

Until a couple of years ago purchasers of TIC interests, in projects subject to California public reports, acquired interests subject to an existing blanket deed of trust or a new blanket deed of trust encumbering the entire property. Bank financing was not available for purchaser loans, so purchasers who could not afford to pay all cash for their interests would have to resort to seller financed loans.

Because TIC purchasers own a property subject to a blanket mortgage, the TIC agreement includes arrangements for purchasers to pay into a cash reserve for the continuing debt service in order to pay down the loan. Due to the risk to all TIC owners of loss of the property if even one owner fails to contribute to payments on the mortgage, the TIC agreement typically allows the other TIC owners to repossess the interest of any TIC owners who are not paying their share of the payment. The terms of the blanket financing or the terms of seller financing may require the TIC owners to refinance the property, which may be complicated if TIC owners cannot borrow enough money to refinance. It also may be difficult for TIC owners to resell their interests if the buyer is



unable to obtain financing.

Recently, a few banks have offered individual financing on the purchase of TIC interests, allowing interests to close free and clear of any blanket financing, due to either a contractual presale clause or other arrangements. While most public reports issued during the last two years have been based on individual financing, the availability of bank financed loans is limited, if available at all. Typically, these loans have balloon payments due in 10 or more years, so owners will have paid only a small fraction of their individual loan by the time the balloon payment is due. While individual financing eliminates the inherent dangers of buying an interest subject to a blanket encumbrance, there are still potential dangers to such a purchase. First, at the end of ten years, individual loans may no longer be available. Second, an owner may not qualify for a loan since the savings and income requirements for TIC loans may be higher than those for

condominium or home loans if the share of ownership is no longer worth enough to support the loan. If TIC's become less popular, lenders may reduce their estimates of value, potentially reducing lending activity on TIC interests.

To apply for a TIC public report, an applicant must submit the Notice of Intention (Common Interest), RE 624. Provisions of Section 11000 et seq. and Article 12 of the Regulations of the Real Estate Commissioner are applicable. While there is no requirement for an incorporated homeowner's association, the TIC agreement must include provisions in compliance with Regulations Sections 2792.4 et seq. This included shared obligations of ownership, similar to provisions found in bylaws and covenants, conditions, and restrictions (CC&R's) for a Common Interest Development, and provisions for assessments for maintenance, operation and management, and property taxes. If there is a blanket encumbrance, the TIC agreement should address owner obligations relative to the shared obligations for the mortgage. A completed Regulations Check List (RE 648) is required.

The Department also requires the subdivider to submit complete details of the financing arrangements for the offering. If the interests will be sold subject to a blanket encumbrance, the applicant should explain the arrangements to be established for the reserve fund to cure defaults on the mortgage, loan to value information on the mortgage, estimated sell-out period and justification for the proposed level of the default fund.

All TIC offerings, other than those offered with individual financing as described above, must include arrangements for the seller to provide the purchaser an appraisal of the assigned unit by a licensed appraiser prior to close of escrow. The TIC offering should allow the purchaser seven days from receipt of the appraisal to review it and to rescind the purchase if he or she is not satisfied with the appraisal.

Because of the risks involved in the purchase of TIC interests, especially those in which the projects will be subject to a blanket encumbrance, the public report

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## Requests for expedited reviews of subdivision filings

The Department of Real Estate (DRE) receives requests for the expedited review of subdivision and budget filings. These requests are reviewed on a case-by-case basis and are considered especially when any of the following circumstances exist:

1. An extreme financial hardship that affects the Subdivider. Such hardships must be documented. DRE will review the documentation submitted to confirm qualification. (Note: It can be argued that each and every subdivider has a financial hardship. DRE must factor reported hardships against overall workload.)
2. Standing Inventory. Evidence may be shown by submitting a recorded Notice of Completion for the project.
3. Affordable Housing projects wherein lots/units will be offered with an "Affordable Housing" incentive to purchase.
4. "Totally Complete" filing package. For more information on submitting a "totally complete" filing refer to the Subdivision Public Report Application Guide (SPRAG) at [http://www.dre.ca.gov/pdf\\_docs/sprag.pdf](http://www.dre.ca.gov/pdf_docs/sprag.pdf)

A Subdivider requesting an expedited review under any of the above circumstances must submit a letter requesting such with the initial filing for the project/phase. If expedited handling is approved, those files will be given priority attention; taking into consideration workload factors which may influence review time. The Subdivider must keep in mind that although DRE will attempt to expedite review, any deficiencies noted must be corrected prior to the issuance of a Public Report. ♦



### Tenancy In Common Projects

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will include extensive disclosures regarding the potential risks involved. Accordingly, documentation required may vary from application to application based on the plan of financing.

Section 11000.1(b) of the Business & Professions Code describes an exemption to the application of the Subdivided Lands Act for undivided interest subdivisions. This exemption does not apply because a TIC purchase is not intended as a risk-based investment, but as a purchase of a residence.

The purchasers should be advised to seek counsel of an attorney before buying to evaluating the risks involved in the transaction. ♦

## Abandoning applications

Business and Professions Code (B&P Code) Section 11018.13 permits the Real Estate Commissioner to abandon an application for subdivision public report if the applicant fails to provide the required documentation.

The DRE has adopted Regulation 2804 to implement B&P Code 11018.13. Under Reg. 2804(a), the DRE may abandon an application for a public report if:

- ❖ The data required by B&P Code 11010 has not been furnished in the three years after the date a public report application was filed;
- ❖ There has been no progress in the file for six months; and
- ❖ The term of any one year extension of the time has expired.

Per Regulations 2804(b)(c), proceedings to abandon a file are initiated by the DRE giving the applicant a 90-day notice, which is to be followed at least 60 days later by a 30-day notice. At the end of the 30-days, the file is deemed abandoned unless, before that time, the DRE grants a one year extension per Regulation 2804(c). A one year extension may be granted on DRE's own motion or on the applicant's petition. Grounds for an extension include mistake, inadvertence, surprise, excusable neglect, and circumstances beyond the applicant's control of that of the applicant's designated representative. ♦

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### Sales Inducements

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any financial arrangements that may be necessary including possible modification to the escrow instructions. In most cases, the subdivision public report will not have to be amended if the inducement occurs at or before the close of escrow and only directly impacts the individual buyers. An amendment is necessary if the inducement/promotion occurs after the close of escrow and the homeowners association is directly affected, such as if the association is an obligee to a surety bond because of an assessment subsidy.

Since the variations of sales inducements and methods of financial arrangements can be complex, subdividers should inquire from the DRE as to what will be required and whether the public report will need to be amended. ♦

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# Duplicate budget package information

When a subdivider submits an application for a final public report for a common interest subdivision, the application should include a Duplicate budget package (DBP). Inside the DPB, the following items should be provided:

- ❖ RE 681
- ❖ Address labels (5 for the SRP and 5 for the subdivider)
- ❖ Vicinity map
- ❖ Tentative map including local conditions for map approval
- ❖ Condominium plan (if the project is a condominium)
- ❖ Plot plan (showing a phasing plan if the project will contain more than one phase)
- ❖ RE 611A for each phase if the subdivider chooses to bond for completion of any common amenities
- ❖ RE 623 (budget) must be submitted for each phase
- ❖ RE 624-A for each phase
- ❖ RE 639 (if the project is a condominium or P.D. conversion)
- ❖ Proposed subsidy agreement (if the subdivider will subsidize assessment payments)
- ❖ Any contracts and/or maintenance agreements that will obligate the homeowners association (HOA)
- ❖ Any proposed CC&R's
- ❖ Bylaws
- ❖ Declarations of Annexation (for phased projects)



If the subdivider is applying for a public report for a subsequent phase of a project and a DBP is required, then a copy of the HOA financial statements, budget(s), assessment delinquency statement and a reserve study may be required.

If the subdivider is applying for an amended public report and a DBP is required then the same information as above should also be provided.

During the processing of common interest subdivision applications, a single responsible party (SRP) is designated by a subdivider to process subdivision applications. All documents submitted by the subdivider and/or his/her representatives should be sent through the SRP. This procedure was implemented so that the subdivider would be able to contact only one party in order to find out about the status of an application, and the DRE would be able to more efficiently process subdivision applications.

For a more streamlined review of the DBP's, here are some suggestions for SRP's to follow:

- Encourage subdividers and their representatives to send all budget information for review through the SRP in complete packages: When returning responses to deficiency notices, information that is submitted should include all of the items covered in the deficiency notice.
- All budgets submitted must be signed and dated by the budget preparer: If revised budgets are submitted, they should be re-signed and re-dated by the budget preparer.
- When a SRP submits documentation to the budget reviewer, a copy should always be sent to the appropriate subdivision deputy.
- All telephone calls regarding the status of a budget review should be made by the SRP. The SRP can then inform the concerned party.
- When a DBP is submitted for a subsequent phase of a project or for an amended public report, it would be helpful if a copy of the most recently issued budget review notice ( RE 660C) was provided for reference purposes.

If the above guidelines are followed, then the DRE review of DBP's can be conducted more efficiently and the subdivision industry will be better served. ♦

## 2007 Legislation

Continued from page 2



project, or a stock cooperative project shall be issued in the tenant's primary language.

The Department of Real Estate sponsored AB 840.

### ***AB 980 (Calderon) Real estate transfer fees: residential property. (Chapter 689)***

Some homebuilders have instituted the use of private transfer fees to fund the maintenance of amenities, improvements or open space. The funds generated by the transfer fee are typically paid to a third party entity, not associated with the developer or homeowner association. These fees are generally imposed upon initial sale of a newly constructed home and upon the 'transfer' or subsequent sales of the home. Existing law does not impose any limits on the amount, duration or use of the transfer fees.

AB 980 requires the disclosure of the existence of a transfer fee for properties that are subject to such a fee. Disclosure will generally be in the form of a recorded notice and a requirement that a seller provide a buyer with a statement indicating, among other things, the amount of the transfer fee based on the asking price and how the fee is calculated.

The California Association of Realtors® sponsored AB 980.

### ***SB 528 (Aanestad) Common Interest Developments: open meetings (Chapter 250)***

Existing law does not require HOA boards to solely adhere to the matters set-forth on the agenda. SB 528 requires all issues to be discussed at a board meeting to be on the agenda so that homeowners have advance notice of what issues the HOA board will be acting on. This bill also requires that meeting notices include the agenda for the meeting. ♦

## Frequently used form packets

All DRE forms can be found at [www.dre.ca.gov](http://www.dre.ca.gov)

### **Preliminary Public Report Packet**

*Includes:* 603, 603A, 603B, 603C, 603D, 605, 612, 612A, 695C, 909

### **Common Interest Packet**

*Includes:* 350, 603, 603A, 603B, 603C, 605, 611, 611A, 611B, 612, 612A, 619, 623, 624, 624A, 639, 643, 648, 681, 684A, 695C, 699, 699C, 909

### **Standard Packet**

*Includes:* 350, 603, 603A, 603B, 603D, 605, 612, 612A, 619, 628, 695C, 699A, 909

### **In-State Amendment/Renewal Packet (*non time-share*)**

*Includes:* 350, 600C, 605, 619, 635, 635A, 643, 695C, 909

### **Out-of-State Registration Packet (*in- and out-of-state*)**

*Includes:* 608, 608A, 608B, 608C, 608D, 626C

### **Completion of Common Facilities Packet**

*Includes:* 611, 611A, 611B, 611C, 611D

### **Completion Arrangements Packet (*in-state*)**

*Includes:* 621, 621A, 621B

### **Time-Share Packet (*in- & out-of-state*)**

*Includes:* 350, 605, 608, 608A, 608B, 608C, 608D, 609, 611, 611A, 611B, 611C, 611D, 613, 619, 623, 624A, 626D, 629, 631, 639, 643C, 648A, 656A, 668, 668A, 681, 695C, 909

